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IETA COMMENTS ON PROPOSED RULEMAKING CR-102: CHAPTER 173-442 WAC - CLEAN AIR RULE & CHAPTER 173-441 WAC - REPORTING OF EMISSIONS OF GREENHOUSE GASES

The **International Emissions Trading Association** (IETA)[1] appreciates this opportunity to share business input on Washington Department of Ecology (DoE)'s proposed Clean Air Rule establishing greenhouse gas (GHG) emissions standards (the Proposed Rule). On behalf of our 150+ multi-sector business membership worldwide, we believe that flexible market instruments – **including trading, broad access to offsets, and cross-border cooperation** – must form the backbone to any jurisdiction's successful climate policy effort.

We welcome Washington State's climate leadership and support for flexible market instruments. **However, while the Proposed Rule is a move in the right direction, we believe that overall environmental and economic effectiveness could be improved in several areas.** Adopting several program design modifications, particularly related to enabling broader trading and regional market linkages, will best position the state to meet its climate goals at least-cost to Washington businesses and consumers.

KEY MESSAGES: BUILDING AN EFFECTIVE CARBON PRICING PROGRAM IN WASHINGTON

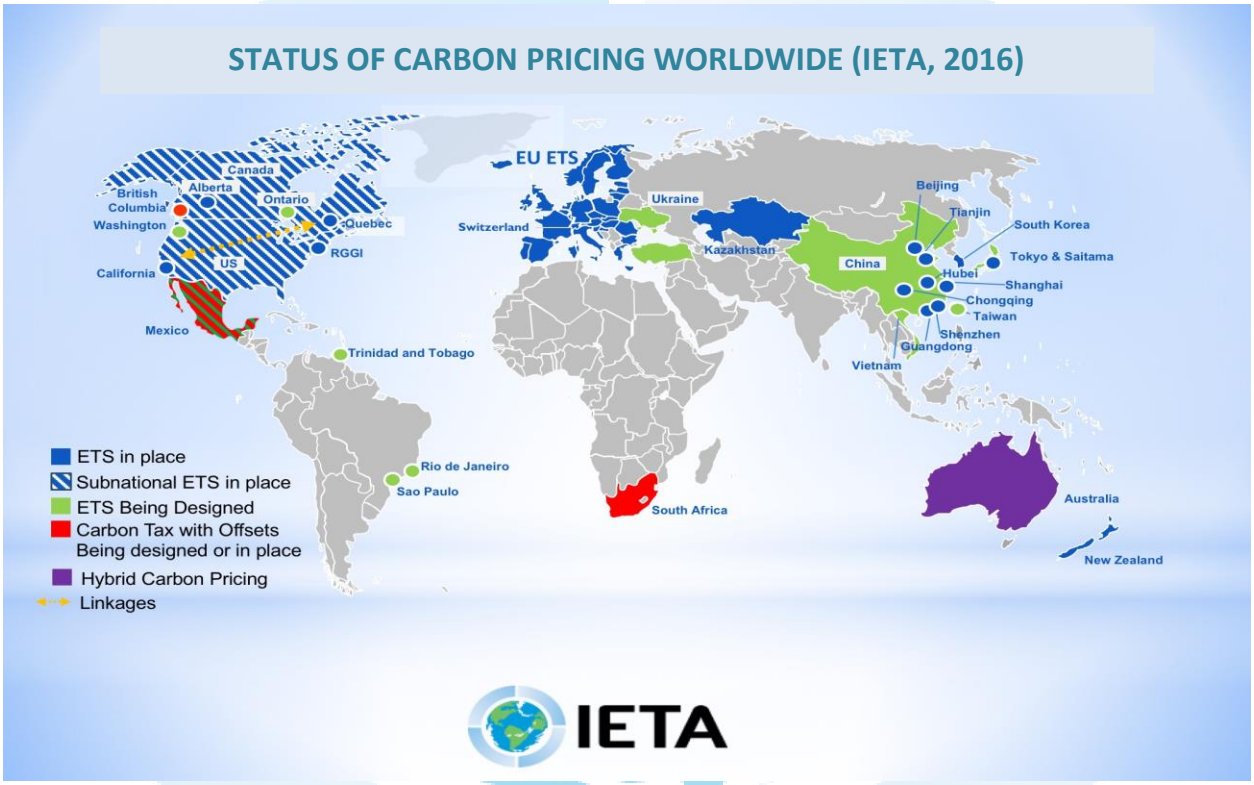
1. Emissions trading, specifically cap-and-trade, **ensures emissions reduction certainty**.
2. Emissions trading achieves **measurable emission reductions at least-cost**.
3. Emissions trading enables **cross-border program linkages, cooperation, and partnerships**.
4. Emissions trading can **most effectively respond to macro-economic fluctuations**.
5. Emissions trading drives **economically-rational, low-carbon innovation solutions**.
6. Emissions trading can best **support low-carbon transitioning for business and consumers**.
7. Emissions trading can **address industry competitiveness and leakage concerns**.
8. Emissions trading provides a **global response to a global challenge**.
9. Emissions trading is **more effective than a carbon tax for creating real reductions in carbon.**

The following input to DoE is structured around three main sections: 1) global carbon pricing trends & outlooks; 2) priority business input; and 3) detailed input on proposed program design elements.

[1] *IETA is the leading global business voice on the design, evaluation, and expansion of greenhouse gas markets and climate finance. IETA's 150+ member companies include some of the world's largest power, industrial, manufacturing and financial corporations. Learn more about IETA at* ***www.ieta.org***.

1. GLOBAL CARBON PRICING TRENDS & OUTLOOKS

As shown in IETA's map below, over 40 national and 20 subnational jurisdictions – representing 25% of global GHG emissions – currently use some method of carbon pricing. Since 2009, **cap-and-trade programs have predominantly driven this growth of carbon pricing worldwide**. Delving further into the global landscape, the **International Carbon Action Partnership (ICAP)'s Status Report 2016**,[2] shows that **40% of global GDP is now covered by emissions trading systems.** This figure is projected to increase to ~50% of GDP by 2017, once China implements its national cap-and-trade system.



Spurred by **Article 6 of the Paris Agreement** (or, informally known as the "markets article"),[3] this bottom-up carbon pricing momentum, particularly regarding international trading and market linkages, will continue to build. Detailed considerations about the implementation of Article 6 are shared in IETA's May 2016 report, "**A Vision for Market Provisions of the Paris Agreement**" and IETA-EDF's April 2016 Joint Report, "**Carbon Pricing: The Paris Agreement's Secret Ingredient**".[4] The international, national and sub-national trends are clear: **emissions trading, specifically cap-and-trade, has become the climate policy tool of choice to keep costs reasonable while inspiring greater levels of ambition going forward.**

[2] *See ICAP's "Status Report 2016", https://icapcarbonaction.com/en/status-report-2016.*

[3] *See UNFCCC 'Paris Agreement' https://unfccc.int/resource/docs/2015/cop21/eng/l09.pdf.*

[4] *All referenced reports can be accessed via the IETA homepage: www.ieta.org.*

2. PRIORITY BUSINESS INPUT

Leveraging two decades of business experience across global environmental markets, IETA offers several priority business insights to inform a vibrant climate program in Washington State.

Measurable Environmental Outcomes Matter. For reasons described throughout this submission, emissions trading contains numerous socio-economic, innovation, linkage and efficiency benefits. This is particularly true in relation to taxation and more prescriptive "non-complementary" climate policy measures. The **hallmark feature of cap-and-trade – which unfortunately, is not the design being proposed by DoE – is a results-based approach that leads to measurable environmental outcomes.** Under this preferred design, the "cap" effectively represents a carbon "budget", or the total number of allowances that are available to the market and compliance entities. These budgets *never exceed a given limit of emissions, and decline over time as measurable GHG targets become more ambitious.* The cap is critical to defensibly and demonstratively achieving environmental policy success and meeting reduction commitments. In contrast, a carbon tax simply cannot guarantee environmental outcomes. Nor is it capable of timely emissions measurement and results-oriented adjustments to ensure climate targets are met.[5] A prime example of a jurisdiction that implemented a carbon tax, but is now failing to meet its projected 2020 climate target is the province of British Columbia.[6]

Ability to Respond to Macro-Economic Shifts & Trends. Historical price data shows that flexible market pricing systems respond to economic downturns with lower prices on carbon – this ability to respond to economic shocks is unique to emissions trading. Unlike the politicized nature of a tax, particularly in California and the U.S., enabling the open market to set the price of carbon allows for better flexibility and avoids price shocks or undue burdens.

Cost-Effectiveness & Containment as Guiding Principles. Cap-and-trade programs not only deliver outcome certainty and respond to macro-economic shifts, but they do so at least-cost to consumers and businesses. Washington State's ambitious post-2020 climate targets will require significant, economy-wide accelerations in deep GHG reductions. **Cost-containment and achieving targets/reductions at the lowest possible cost should serve as core guiding principles as the Proposed Rule is finalized.** DoE's policy evaluations and decision-making efforts should identify (and ultimately enable) least-cost abatement opportunities, including cost-benefits of full-scale market trading scenarios, a vibrant offsets market, and achieving program alignment and linkage.

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[5] *With a carbon tax, the price is known (and subjectively set by government) but the expected quantity of GHG reductions achieved is unknown year over year. The policy, political and industry risks associated with the tax vs. quantity approach to pricing carbon is captured in E. Haites' June 2016 report, Carbon Pricing Options for Canada.*

[6] *British Columbia implemented a carbon tax in 2008, but while much-acclaimed, it has failed to effectively reduce greenhouse gas emissions. Instead, after 8 years in existence, B.C.'s emissions are projected to increase +30% by 2030, while Alberta, Quebec, and Ontario are each expected to reduce emissions in excess of 20% in the same period. This gives an evidence-based, clear and poignant story in support of flexible market-based systems.*

Enable Near & Longer-Term Market Linkages. Throughout the remainder of the rule-making process, a top priority for DoE should be the pursuit of a flexible system, **capable of effectively linking – fully or partially – to existing or soon-to-be launched regional markets.** Structuring Washington's future program to gradually ratchet-up climate ambition while ratcheting-down emissions, will prove critical if deep, broad and sustainable linkages are to flourish. The benefits of cooperative approaches and regional linkage are clear: the bigger and broader the market, the wider the range of abatement opportunities and improved efficiencies, thereby driving-down program costs while driving-up clean projects, jobs, and market opportunities.

Enable Policy Harmonization & Alignment. Moving forward, DoE must look across its borders to ensure that program rules and processes, once adopted, are complementary and readily adaptable to rapidly-changing carbon policy and market landscapes. We urge officials to closely track developments that will – or could potentially – affect the state program design and *de facto* dynamics in Oregon, California and beyond. Now is the best time to be aware of, and account for, any challenges that could emerge down the line. IETA is well-positioned to support this information exchange and can help ensure that DoE has the latest policy and market information and outlooks relevant to the Washington carbon landscape.

Recognize Early Action. Businesses that have been proactive in reducing GHG emissions prior to the development of the Proposed Rule should be recognized and rewarded under the Rule. These proactive actions must be clearly defensible and supported by documentation, as may be mandated by the program. Under a flexible market mechanism, "early action" can be recognized through a variety of design options, such as allowance allocations or dedicated offset issuances.

Borrow, Learn and Leverage Existing Programs. Moving forward, DoE should rely *heavily* on the experiences, lessons learned and best practices from existing carbon pricing programs – across North America and beyond. Building on – or at least **ensuring complementarity** with – established programs **will enhance efficiencies, cross-border harmonization, and broader program integrity** (e.g. avoid double counting), while strengthening climate cooperation and potentially deepening policy ambitions.

Avoid Duplicative & Non-Complementary Measures. Non-market measures – such as government incentives, standards, R&D support etc. – can play roles in helping to meet climate goals. However, **complementary measures can also create inefficiencies and increase overall program costs if not designed to ensure true and transparent "complementarity" with the carbon market**. DoE's rule, once final, must align with existing state legislation (e.g. 2007 Act creating GHG performance standard for in-state fossil generation, Ch. 80.70 RCW) and prepare to complement future climate and energy measures.[7] We urge officials to take meticulous care and be painstakingly thorough to ensure that all existing and future environmental policies facilitate, rather than impede, Washington's ability to realize GHG reductions at least-cost.

[7] *Additional insight into the contradictions between the Proposed Rule and Ch. 80.70 RCW can be found in the July 2016 comments submitted to DoE by The Climate Trust.*

3. DETAILED INPUT ON PROPOSED PROGRAM DESIGN ELEMENTS

A. TRADING PROVISIONS & MAXIMIZING REGIONAL CONSISTENCY

Proposed Rule is artificially constrained by its approach to trading and should be broadened. A more robust mechanism that allows for fulsome trading of compliance instruments (designated as ERUs or otherwise) should be explored. Initially, this could be pursued at a state level, then later compatible with other existing non-state programs. We strongly encourage DoE to reconsider some of the limitations in its proposal, and IETA offers its deep cross-border and market expertise to help inform these trading provision modifications.

Non-Compliance Entity Market Participation. IETA strongly encourages DoE to revisit the provision in the Proposed Rule denying third-party (or non-compliance entity) ERU ownership and trading opportunities. This proposed participant constraint is a major concern that could lead to potentially dramatic implications on the future success and expansion of Washington's program. All existing compliance markets, including RGGI, California-Quebec (WCI), Alberta, and the EU ETS, expressly allow trading of compliance instruments amongst compliance and non-compliance (or voluntary/third-party) participants. All successful markets, including environmental commodity markets, rely on broad market participation that drives liquidity, transparent price discovery, and capital. Without broad participation by financial intermediaries and other third party participants, ERU trading will most certainly be limited to a small number of compliance entities. Limited participation could stifle market efficiency and other potential benefits, including linkage prospects. It could also effectively drive market power into the hands of only a few entities, leading to unintended consequences around market manipulation and barriers to linkage with other jurisdictions.

Ensuring Common Nomenclature & Standards. We urge DoE to use existing standards, including across both systems (e.g. CITSS, SGER) and terminology (e.g. Allowances, Offsets, EPCs etc.). This would pre-empt future confusion among market participants, while keeping a watch on future linkage opportunities. DoE should continue to work closely with partner jurisdictions to the fullest extent possible, so Washington's program can easily be integrated in accord with future market developments.

B. BUILDING & LINKING BEST-IN-CLASS OFFSETS PROGRAM

Washington is extremely well-positioned to develop a strong, best-in-class offsets system. IETA applauds DoE for its expansive recognition of activities and programs recognized as generating ERUs, as well as the criteria that such initiatives must result in real, permanent, enforceable, and verifiable emissions reductions. The following underscores the important role and merits played by offsets.

Offsets Reduce Costs While Preserving Environmental Integrity. Offsets provide an alternative for regulated emitters to substitute real GHG emission reductions made outside capped sectors, presumably at lower cost, for emission reductions in their own facility. This provides the same benefit to the environment as an emission reduction at the regulated facility but at a lower cost. It is of paramount importance, as DoE appreciates, to ensure that each compliance offset issued and entering a system represent a real, discrete, additional and verifiable tonne of GHG emissions reduced or sequestered.

Offsets Drive Innovation. By their very definition, offsets act as an innovative and direct financing tool, driving the implementation of new technologies and practices that would not have happened under business as usual. The tool provides a new way for technologies and resource management practices to progress from the lab to the field – providing fertile opportunity for partnerships between the research community and business. Years of industry experience across multiple programs and regions have demonstrated that properly designed offset systems drive clean innovation and entrepreneurialism by providing a clear price signal upon which to invest. A well-designed offset system builds and sustains an ecosystem of "clean" innovators and entrepreneurs who help us reach our de-carbonization goals.

Offsets Provide Economic Benefits & Preserve Competitiveness. Trading and access to offset reductions provide necessary compliance and policy flexibility. These measures can help drive low-carbon innovative solutions and investments, keep compliance and program costs to a minimum, capitalize on new revenue streams, manage competitiveness concerns, and pursue clean investments on a logical timescale. Flexibility also gives regulated industries the ability to gradually transition and meet compliance obligations, while adopting new low-carbon strategies, technologies and processes that work best for their operations, human resource capacity, supply chains, and consumers.

Offsets Help Drive Levels of Ambition & Linkages. Across today's fragmented carbon pricing landscape (see Section 1), eligible, least-cost offsets will become more important least-cost compliance tools to meet climate targets and increase levels of ambition. Carbon programs will need more – not fewer – eligible GHG projects and associated reductions to 2030 and beyond. The full or partial linking of jurisdictional efforts through mutual recognition of tradable units, including offsets, provides greater certainty that units will have value into the future and be adequately financed.

C. EMPOWERING THIRD-PARTY REGISTRY (OR REGISTRIES)

Empowering Third-Party Registry (or Registries): Given DoE's ambitious timeline to finalize and implement its Rule, we encourage the state to consider empowering third-party registries to administer Washington's registry. Such decisions should be guided by the need to encourage program and market efficiencies and transparency, while also building program credibility and confidence. Third-parties can provide immediate, trusted offsets infrastructure to reduce state burdens, as well as facilitate the most efficient use of scarce resources. Third-party registries can also simplify the process for "on-boarding" early action credits, as existing projects are already registered on third party registries.

ERU Registry Unknowns. Washington's proposed ERU registry requires more details on design, governance, operationalization, interface with market participants, and more. Presumably, the registry will track all tradeable units (EPCs and imports/exports of allowances and offsets) and therefore be the most vital piece of Washington's program infrastructure. Additional information and stakeholder engagement is required as Washington's rule is finalized and the registry moves from concept to operationalization.

Transparency & Engagement. The registry (or registries) must publicly display ERU – including EPC/offset-type – project documents and ownerships. For offsets, it must ensure access and viewing by the general public in order to draw links between offset projects and credits used for compliance. The tracking of offset credits also allows for traceability and accountability around offsets credits, thereby increasing transparency, heightening program integrity, and providing necessary access for the public.

Common & Compatible Market Infrastructure and Oversight. Washington's registry should support and manage all (or some, depending on its future relationship to CITSS) administrative efforts associated with the communication and display of offset projects, credit transfers, and retirements. DoE should develop clear guidance and operational/performance level agreements or contracts for registry service(s). These clear "rules of the game" and contractual arrangements should only help to strengthen program confidence, clarity and participation.

Compatibility & Linkage with Existing Registries. As DoE moves forward with offset program design and core infrastructure decisions, compatibility and potential linkage to WCI partner jurisdictions should be kept front-of-mind. Prioritizing these two considerations will help increase program efficiencies and reduce costs/burdens to business complying or investing across jurisdictions. Harmonized infrastructure enables linkage and broadens markets, thereby containing costs, addressing competitiveness, heightening market efficiencies, and achieving broader climate benefits and co-benefits across Washington State and beyond.

Avoid ERU/Offset Usage Limits. IETA believes that all market-based programs, including Washington's, should avoid limiting the use of eligible offsets for compliance purposes to a specific percentage of an entity's overall obligation. These subjective quantitative limits restrict cost-containment opportunities and other benefits (e.g. linkage, socio-economic co-benefits, etc.) that underpin a broad and vibrant offset market.

Offset Protocol Development. We applaud DoE's proposal to adopt a broad and diverse range of eligible, economically-viable, and potentially scalable offset protocols. However, we would urge Washington to avoid the imposition of artificial geographic constraints, as proposed. Building a compliance offset system that allows a diversity of protocols and project types, as well as freedom of use by covered entities, will invigorate Washington's program while effectively containing compliance and program costs.

D. ADDRESSING COMPETITIVENESS & LEAKAGE

Carbon leakage occurs when direct and indirect costs produced by an asymmetrical climate policy has a material impact on competitiveness that results in industrial production and new investments moving outside a regulated region together with the associated emissions.

We strongly believe and advocate for compensation at an "appropriate level" to be provided to industry sectors facing "front-running" climate policies that are essential to avoid leakage as a result of competition with international – or in the Canadian context, interprovincial – competitors not facing similar costs.

Determining "appropriate compensation" should be guided by IETA's key principles for carbon leakage protection, a process that should reward the cleanest and most efficient entities. While adequate protection for competitiveness must be ensured, the appropriate compensation must not result in unintended consequence of discouraging the switch to economically competitive low-carbon products. Further, Washington's carbon leakage provisions should avoid "locking-in"" carbon intensive technologies and penalizing the development of low-carbon technologies or alternative solutions. **We believe that an ideal protection method for addressing carbon leakage should:**

- Be as targeted, sufficient, predictable, fair and proportionate as possible;
- Be harmonized across jurisdictions;
- Compensate for both direct and indirect costs;
- Encourage overall emissions reductions by all traded sectors;
- Ensure the most efficient facilities do not face undue carbon costs vs. international competition;
- Not affect the trading system goal to cost-effectively reduce emissions;
- Not affect the trading system goal in stimulating clean investments and innovation;
- Not put into question the trading system's functionality, including its principles of efficiency, cost-effectiveness, and ensuring liquidity;
- Be fully rational, transparent and defensible;
- Be based on evidence not theory; and
- Be transitional and linked to achieving a "level-playing field" for industrial competitiveness, particularly as more jurisdictions adopt climate policies and programs.

Accounting for International Trends & Approach. While making program design decisions to combat competitiveness and leakage concerns, Washington account for carbon developments transpiring in other priority jurisdictions. These quickly-evolving policy landscapes speak to treatment of both direct and indirect costs affecting industries, as well as the net effect after comparing one system versus other national and regional compensation schemes. At the same time, Washington must also dedicate time to carefully evaluating whether the potential asymmetry is of a permanent nature.[8]

[8] *See IETA's 2015 'Addressing Competitiveness & Leakage Concerns' for further analysis and details.*

E. ELECTRICITY IMPORT & EXPORT PARITY DESIGN OPTIONS

DoE should explore how best to ensure parity between electricity imports and exports. Requiring in-state electric power generation to bear carbon costs not faced by power delivered into Washington will simply cause leakage, raising prices within the state with no net carbon reduction. Other states and provinces within the region, including California, have successfully imposed carbon costs on imported electricity and there is nothing preventing Washington from doing so as well. Similarly, in-state power generation that is delivered into one of these other programs should not be required to pay multiple times for the same ton of carbon.

CONCLUSION

IETA appreciates this opportunity to record our joint comments related to Washington State's proposed Clean Air Rule. Our collective, diverse membership remains committed to supporting the successful creation, launch, and growth of market-based carbon pricing in Washington to help achieve the state's future climate targets at least-cost. If you have questions, or require further information about our comments, please contact IETA's Director of the Americas, Katie Sullivan (**sullivan@ieta.org**).

Sincerely,

Dirk Forrister
IETA President and CEO